

Canadian Overseas Petroleum Limited
(formerly Velo Energy Inc.)
Interim Consolidated Financial Statements
As at and for the six month period ended
June 30, 2010

Canadian Overseas Petroleum Limited
Consolidated Balance Sheets (unaudited)
(in Canadian dollars)

	June 30, 2010	December 31, 2009
Assets		
Current		
Cash and cash equivalents	\$3,429,973	\$1,408,528
Term deposits	30,000	30,000
Accounts receivable	128,240	75,192
Prepaid expenses	80,626	277,137
	3,668,839	1,790,857
Long-term rent deposit and prepayments	42,727	70,227
Office equipment	65,814	70,224
	\$3,777,380	\$1,931,308
Liabilities		
Current		
Accounts payable and accrued liabilities	\$295,573	\$1,900,534
Loan (note 3)	-	1,802,315
	295,573	3,702,849
Shareholders' Equity (Deficiency)		
Share capital (note 4)	15,072,562	8,062,924
Warrants (note 4)	1,647,000	306,000
Contributed surplus	1,657,494	1,074,494
Deficit	(14,895,249)	(11,214,959)
	3,481,807	(1,771,541)
	\$3,777,380	\$1,931,308

Nature of operations and going concern (Note 1)
Commitments and contractual obligations (Note 5)

See accompanying notes to the interim consolidated financial statements.

Canadian Overseas Petroleum Limited
Consolidated Statements of Operations, Comprehensive Loss and Deficit (unaudited)
(in Canadian dollars)

	Three months June 30, 2010	Three months June 30, 2009	Six months June 30, 2010	Six months June 30, 2009
Revenue				
Management services	\$ -	\$ -	\$ 6,060	\$ -
Expenses				
General and administrative (note 6)	1,199,044	29,148	2,638,862	44,211
Interest and financing charges (note 3)	190,260	-	460,660	-
Depreciation	2,692	-	6,107	-
Stock based compensation (note 4)	583,000	-	583,000	-
Foreign exchange (gain) loss	405	-	(216)	-
	<u>1,975,401</u>	29,148	<u>3,688,413</u>	44,211
Other items				
Interest income	1,702	12,809	2,063	26,328
Net loss and comprehensive loss	<u>(1,973,699)</u>	(16,339)	<u>(3,680,290)</u>	(17,883)
Deficit, beginning of period	<u>(12,921,550)</u>	(6,594,756)	<u>(11,214,959)</u>	(6,593,212)
Deficit, end of period	<u><u>\$(14,895,249)</u></u>	\$(6,611,095)	<u><u>\$(14,895,249)</u></u>	\$(6,611,095)
Loss per share (basic and diluted)	<u><u>\$(0.10)</u></u>	\$(0.00)	<u><u>\$(0.20)</u></u>	\$(0.00)
Weighted average number of shares outstanding (basic and diluted)	<u><u>19,879,816</u></u>	16,402,222	<u><u>18,150,626</u></u>	16,402,222

See accompanying notes to the interim consolidated financial statements.

Canadian Overseas Petroleum Limited
Consolidated Statements of Cash Flows (unaudited)
(in Canadian dollars)

	Three months June 30, 2010	Three months June 30, 2009	Three months June 30, 2010	Six months June 30, 2009
Cash Provided By (Used In)				
Operating Activities				
Net loss	\$(1,973,699)	\$(16,339)	\$(3,680,290)	\$(17,883)
Add non-cash items:				
Stock-based compensation	583,000	-	583,000	-
Fair value of Endeavour warrants	168,000	-	237,000	-
Depreciation	2,692	-	6,107	-
Unrealized foreign exchange (gain) loss	346	-	(330)	-
Funds used in operations	(1,219,661)	(16,339)	(2,854,513)	(17,883)
Net change in non-cash working capital	(2,155,669)	2,278	(1,305,983)	(17,083)
	(3,375,330)	(14,061)	(4,160,496)	(34,966)
Financing Activities				
Issuance of common shares and warrants, net of share issue costs	8,183,638	-	8,183,638	-
Repayment of loan	(2,000,000)	-	(2,000,000)	-
	6,183,638	-	6,183,638	-
Investing Activities				
Additions of office equipment	-	-	(1,897)	-
Disposals of office equipment	200	-	200	-
	200	-	(1,697)	-
Increase (decrease) in cash during period	2,808,508	(14,061)	2,021,445	(34,966)
Cash and cash equivalents, beginning of period	621,465	1,330,053	1,408,528	1,350,958
Cash and cash equivalents, end of period	\$3,429,973	\$1,315,992	\$3,429,973	\$1,315,992
Cash and cash equivalents:				
Cash	\$46,973	\$15,992	\$46,973	\$15,992
Term deposits	3,383,000	1,300,000	3,383,000	1,300,000
	\$3,429,973	\$1,315,992	\$3,429,973	\$1,315,992

See accompanying notes to the interim consolidated financial statements.

Canadian Overseas Petroleum Limited

Notes to Unaudited Interim Consolidated Financial Statements

As at and for the six month period ended June 30, 2010

1. NATURE OF OPERATIONS AND GOING CONCERN

Canadian Overseas Petroleum Limited (“COPL” or the “Company”), formerly Velo Energy Inc., was incorporated on July 8, 2004 and was originally classified as a Capital Pool Company under Policy 2.4 of the TSX Venture Exchange Corporate Finance Manual and Policies. Effective May 31, 2006, the Company purchased all of the outstanding shares of Velo Energy Ltd. through the issuance of 833,334 common shares (3,333,334 pre-consolidation common shares) of the Company. This arm’s length transaction constituted the Company’s Qualifying Transaction under the rules of the TSX Venture Exchange. The Company’s oil and natural gas operations were focused in southern Alberta. On July 9, 2008 the Company sold Velo Energy Ltd. to an unrelated party.

In August 2009, the Company’s management and Board of Directors were replaced and COPL’s focus was changed to oil exploration and development in the United Kingdom (“UK”) Central North Sea.

On October 6, 2009, the Company signed a share purchase agreement to acquire 100% of the outstanding common shares of North Sea Oil Ltd. (“NSO”), a private company incorporated in Alberta, Canada and 100% of the outstanding common shares of North Sea Oil Exploration Limited (“NSOE”), a private company incorporated in England and Wales, UK.

Effective August 3, 2010, the Company’s name was changed from Velo Energy Inc. to Canadian Overseas Petroleum Limited and the Company’s common shares were consolidated on a one for four basis (further discussed in Note 4).

These consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The continuing operations of the Company are dependent upon its ability to acquire oil and natural gas properties, to obtain adequate financing to explore and develop these properties and generate profitable operations in the future. As at June 30, 2010, the Company had an accumulated deficit of \$14,895,249, shareholders’ equity of \$3,481,807 and working capital of \$3,373,266.

The current economic environment has made access to debt and equity markets difficult, where cost of capital has increased while the availability of capital has decreased. No assurance can be provided that the Company will be able to raise additional funds required to set up and develop profitable operations.

These financial statements do not reflect adjustments to carrying values of assets and liabilities and the balance sheet reclassifications that would be necessary if the going concern assumption were not appropriate, and such adjustments could be material.

2. SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements follow the same accounting policies as the most recent annual audited financial statements. The notes to these unaudited interim consolidated financial statements do not conform in all respects to the note disclosure requirements of Canadian generally accepted accounting principles (“GAAP”) for annual financial statements. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements as at and for the year ended December 31, 2009.

Canadian Overseas Petroleum Limited

Notes to Unaudited Interim Consolidated Financial Statements

As at and for the six month period ended June 30, 2010

3. LOAN

On December 11, 2009, the Company signed a Bridge Loan agreement for \$2,000,000 with Endeavour Financial Corporation (“Endeavour”) to finance the Company’s working capital needs. The Bridge Loan maturity was December 14, 2010 and the loan bore interest at a rate of 10% per annum, payable at maturity or an earlier repayment date. The loan agreement also included a provision that in the event the Company completes any financing, the proceeds should be used to first repay the Bridge Loan together with accrued interest. Accordingly, on June 7, 2010, subsequent to the Private Placement (discussed further in note 4) the Company repaid the Bridge Loan in full, together with \$95,890 of accrued interest.

4. SHARE CAPITAL

a) Authorized and Issued Common Shares

Authorized

An unlimited number of common shares, without nominal or par value and an unlimited number of preferred shares, issuable in series.

Issued

The issued share capital is as follows:

	Pre- Consolidation Number of Common Shares	Post- Consolidation Number of Common Shares	Amount
Balance, December 31, 2009 (i)	66,608,888	16,652,222	\$ 8,062,924
Issued for payment of Bridge Loan fees (ii)	721,694	180,424	167,000
Issued pursuant to private placement (iii)	27,490,315	6,872,579	6,955,095
Issued for payment of finders’ fees on private placement (iv)	1,042,841	260,710	263,852
Share issue cost	-	-	(376,309)
Balance, June 30, 2010 (i)	95,863,738	23,965,935	\$ 15,072,562

Further to shareholders’ and board of directors’ approvals and effective August 3, 2010, the Company’s common shares were consolidated on a one for four basis, i.e. one post-consolidation common share for every four pre-consolidation common shares. Common share numbers and earnings per share amounts have been retroactively adjusted to reflect the share consolidation.

- (i) The number of common shares includes 250,000 common shares (1,000,000 pre-consolidation common shares) held in escrow. The shares held in escrow are accounted for as contingently returnable shares at June 30, 2010, which were not considered outstanding and are not included in the computation of basic loss per share until they are released from escrow. The TSX-V conditional approval of this transaction, initially granted until June 30, 2010, was extended until December 31, 2010.

Canadian Overseas Petroleum Limited

Notes to Unaudited Interim Consolidated Financial Statements

As at and for the six month period ended June 30, 2010

4. SHARE CAPITAL (continued)

a) Authorized and Issued Common Shares (continued)

- (ii) On May 5, 2010, the Company issued to Endeavour 180,424 common shares (721,694 pre-consolidation common shares) as payment for a fee of \$167,000 in respect of the Bridge Loan. Pursuant to the Bridge Loan agreement, the fee was due if the loan was not repaid in full by April 1, 2010. The number of common shares was calculated based on the 5-day volume weighted average closing price of the Company's shares immediately before April 1, 2010. The fee of \$167,000 was recognized in Consolidated Statement of Operations, Comprehensive Loss and Deficit as interest and financing charges for the six months ended June 30, 2010.
- (iii) On May 14, 2010 and May 21, 2010, the Company closed the private placement of 6,872,579 units at \$1.20 per unit (27,490,315 pre-consolidation units at \$0.30 per unit) for total gross proceeds of \$8,247,095. Each unit consists of one common share and one half of a share purchase warrant. Each whole warrant will entitle the holder to acquire an additional common share at an exercise price of \$2.00 (pre-consolidation exercise price of \$0.50) expiring November 14, 2011. The fair value of the share purchase warrants issued was estimated at \$1,292,000 using a Black-Scholes option pricing model with the following assumptions:

	2010
Risk free interest rate	2.0%
Weighted average years	1.5
Expected volatility	100%
Expected dividend yield	0%

All units issued further to this private placement are subject to resale restrictions and cannot be resold until four months and one day after the date of issue.

- (iv) The Company paid, whenever applicable, a finder's fee by issuing subscription units equivalent to 5% of the units subscribed via a particular broker. As the result, there were 260,710 units (1,042,841 pre-consolidation units) issued as finder's fees, with exercise price and expiry date of the share purchase warrants consistent with the warrants issued as part of the private placement. The value of \$312,852, representing the subscription value of the units issued as finder's fees together with legal fees of \$63,457, was recognized as share issue costs. The fair value of share purchase warrants issued as finder's fee was estimated at \$49,000 using a Black-Scholes option pricing model with the same assumptions as noted above. Similar to units issued further to the private placement, the units issued as finder's fees are subject to resale restriction and can not be resold until four months and one day after the date of issue.

Canadian Overseas Petroleum Limited

Notes to Unaudited Interim Consolidated Financial Statements

As at and for the six month period ended June 30, 2010

SHARE CAPITAL (continued)**b) Warrants**

The summary of status of the Company's share purchase warrants as at June 30, 2010 is as follows:

Post-consolidation

	Balance January 1, 2010	Granted	Balance June 30, 2010	Exercise Price	Expiry Date
Endeavour Warrants	125,000	-	125,000	\$2.00	December 10, 2010
Endeavour Warrants	300,000	-	300,000	\$2.00	December 14, 2010
Private Placement Warrants (Note 4 a iii)	-	3,436,291	3,436,291	\$2.00	November 14, 2011
Finder's Fee Warrants (Note 4 a iv)	-	130,355	130,355	\$2.00	November 14, 2011
	425,000	3,566,646	3,991,646	\$2.00	

Pre –consolidation

	Balance January 1, 2010	Granted	Balance June 30, 2010	Exercise Price	Expiry Date
Endeavour Warrants	500,000	-	500,000	\$0.50	December 10, 2010
Endeavour Warrants	1,200,000	-	1,200,000	\$0.50	December 14, 2010
Private Placement Warrants (Note 4 a iii)	-	13,745,162	13,745,162	\$0.50	November 14, 2011
Finder's Fee Warrants (Note 4 a iv)	-	521,421	521,421	\$0.50	November 14, 2011
	1,700,000	14,266,583	15,966,583	\$0.50	

No share purchase warrants were exercised during the six month period ended June 30, 2010.

c) Incentive Stock Options

The Company has a stock option plan where the number of common shares reserved under the plan shall not exceed 10% of the issued and outstanding common shares and the number reserved for any one individual may not exceed 5% of the issued and outstanding shares. Exercise prices for stock options granted are determined by the closing market price on the day before the date of grant.

On June 1, 2010, the Company granted 662,500 stock options (2,650,000 pre-consolidation stock options) to certain directors and officers and consultants to acquire common shares at an exercise price of \$1.20 (\$0.30 pre-consolidation exercise price). The stock options vest immediately and expire in 5 years.

SHARE CAPITAL (continued)

c) Incentive Stock Options (continued)

Stock-based compensation expense of \$583,000 for the stock options granted has been recognized for the period ended June 30, 2010. The fair value of each option granted is estimated on the date of grant using a Black-Scholes option pricing model with the following assumptions:

	2010
Risk free interest rate	2.0%
Weighted average years	4.0
Expected volatility	100%
Expected dividend yield	0%

As at June 30, 2010 there were in total 2,065,000 stock options (8,260,000 pre-consolidation stock options) to purchase common shares outstanding and exercisable with an exercise price of \$0.80 - \$1.20 per share (pre-consolidation exercise price of \$0.20 - \$0.30 per share) and a remaining contractual life of 4 - 5 years.

No stock options were exercised and/or expired during the six month period ended June 30, 2010.

5. COMMITMENTS AND CONTRACTUAL OBLIGATIONS

As at June 30, 2010, the Company has the following contractual obligations:

	Total	Less than One Year	One to Three Years	Four to Five Years	After Five Years
Office lease	\$4,588,000	\$535,000	\$1,069,000	\$1,069,000	\$1,915,000
Financial advisory services	170,000	170,000	-	-	-
	<u>\$4,758,000</u>	<u>\$705,000</u>	<u>\$ 1,069,000</u>	<u>\$1,069,000</u>	<u>\$1,915,000</u>

Office Lease

The Company is committed under an operating lease agreement for the rental of office space in Calgary. The approximate lease payments total to \$4.6 million and are payable over the next 10 years.

Financial Advisory Services

The obligation in respect of financial advisory services relate to an agreement with Endeavour International. The agreement is in effect until June 10, 2011, with an option to extend, if agreed by both parties.

The Company is currently pursuing contracts that will require additional financing. The ability of the Company to meet the above commitments is dependent on its ability to obtain additional financing.

Canadian Overseas Petroleum Limited

Notes to Unaudited Interim Consolidated Financial Statements

As at and for the six month period ended June 30, 2010

6. RELATED PARTY TRANSACTIONS

Transactions are with the Company's directors and officers in the form of consulting services totaling \$529,000 for the six months and \$170,500 for the three months ended June 30, 2010. These transactions occurred in the normal course of business and have been recorded at exchange amounts based on commercial rates and terms agreed to in the related consulting contracts.

As at June 30, 2010, there were no outstanding amounts with related parties in respect of consulting fees, as compared to \$701,400 of accrued consulting fees as at December 31, 2009.

During the first half of 2009, the Company incurred management fees of \$3,000 with a company controlled by a director of the Company at that time. These transactions were in the normal course of business.

7. FINANCIAL INSTRUMENTS

The Company is exposed to credit and interest rate risk on its financial instruments. There were no changes to the Company's exposure to these risks, or the objectives, policies and processes to manage these risks from December 31, 2009.

As at June 30, 2010, the fair values of all financial instruments approximated their carrying values due to their short-term maturity. The Company categorizes its financial instruments carried at fair value into one of three different levels depending on the observability of the inputs employed in their measurement. Cash and cash equivalents and term deposits have been categorized as Level 1 financial instruments. There have been no transfers between levels during the six month period ended June 30, 2010.

8. CAPITAL MANAGEMENT

In the management of capital, the Company includes shareholders' equity (deficiency) and interest bearing debt defined as long term loans and current portion of long-term loans. Shareholders' equity includes share capital, warrants, contributed surplus and deficit.

The Company is not subject to any external capital requirements. There were no changes in the Company's capital management policies during the six month period ended June 30, 2010.

As at June 30, 2010, the Company had shareholders' equity of \$3,481,807 and working capital of \$3,373,266. Management of the Company is currently working on obtaining additional financing.